

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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, ID No.

Telephone Number:

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CC:CORP:B06

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Date:

April 20, 2010

### Legend

Distributing =

Controlled 1 =

Controlled 2 =

Shareholder 1 =

Shareholder 2 =

Business A =

Dear :

This letter responds to your October 26, 2009 letter from your authorized representative requesting rulings on certain Federal income tax consequences of a proposed transaction. Additional information was received in letters dated November 29, 2009,

March 5, 2010, March 25, 2010 and March 30, 2010. The information provided in those letters is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (described below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporations, or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or either of the controlled corporations (see § 355(e) and § 1.355-7).

#### Facts

Distributing is an S corporation engaged in Business A. The stock of Distributing is owned equally by Shareholder 1 and Shareholder 2. Shareholder 1 and Shareholder 2 disagree on how to run Distributing. Accordingly, they have agreed to separate Distributing into two corporations with each shareholder running its portion of Business A through a newly-formed corporation.

Financial information submitted by Distributing indicates that Distributing's Business A business has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

#### Proposed Transaction

For what the parties to the transaction represent are valid business reasons, Distributing has proposed the following transaction (the "Proposed Transaction"):

- (i) Distributing will form Controlled 1 and Controlled 2 (collectively, the "Controlled corporations"). Upon formation, each Controlled corporation will be a cash method taxpayer, will file its tax returns on a calendar year and will elect S status.
- (ii) Distributing will transfer one-half of its assets to Controlled 1 in exchange for all of the Controlled 1 stock and the assumption by Controlled 1 of the liabilities associated with the transferred assets ("Contribution 1").

- (iii) Distributing will transfer one-half of its assets to Controlled 2 in exchange for all of the Controlled 2 stock and the assumption by Controlled 2 of the liabilities associated with the transferred assets ("Contribution 2") (Contribution 1 and Contribution 2 are collectively known as the "Contributions").
- (iv) Distributing will distribute all of the Controlled 1 stock to Shareholder 1 in exchange for all of that shareholder's Distributing stock.
- (v) Distributing will distribute all of the Controlled 2 stock to Shareholder 2 in exchange for all of that shareholder's Distributing stock (steps (iv) and (v) are collectively called the "Distribution").
- (vi) Distributing will liquidate.

## Representations

The parties to the transaction have made the following representations:

- (a) Distributing, Controlled 1, Controlled 2, and each of their respective shareholders will pay their own expenses incurred in connection with the Proposed Transaction.
- (b) There is no indebtedness owed by Controlled 1 or Controlled 2 to Distributing after the Distribution.
- (c) The fair market value of the Controlled 1 stock received by Shareholder 1 will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder 1 in the exchange, and the fair market value of the Controlled 2 stock received by Shareholder 2 will be approximately equal to the fair market value of the Distributing stock surrendered by Shareholder 2 in the exchange.
- (d) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (e) The five years of financial information submitted on behalf of Distributing is representative of its present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) The five years of financial information submitted on behalf of the assets and liabilities to be contributed to Controlled 1 is representative of the business's present operation,

and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(g) The five years of financial information submitted on behalf of the assets and liabilities to be contributed to Controlled 2 is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.

(h) Following the transaction, Controlled 1 and Controlled 2 will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of Business A conducted by Distributing prior to consummation of the Proposed Transaction.

(i) The Distribution is carried out for the following corporate business purposes: (a) to achieve each shareholder's individual business objective in Business A; (b) to increase the operating efficiency of each new S corporation; and (c) to strengthen the company's financial position of each new S corporation. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.

(j) The Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing, Controlled 1, Controlled 2, or collectively.

(k) The total adjusted basis and fair market value of the assets Distributing will transfer to Controlled 1 in Contribution 1 will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled 1 in connection with the exchange, (ii) the amount of any liabilities owed to Controlled 1 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing from Controlled 1 in connection with the exchange.

(l) The total adjusted basis and fair market value of the assets Distributing will transfer to Controlled 2 in Contribution 2 will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled 2 in connection with the exchange, (ii) the amount of any liabilities owed to Controlled 2 by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing from Controlled 2 in connection with the exchange.

(k) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled 1 and Controlled 2 in the Contributions, if any, and the liabilities to which the transferred assets are subject, if any, were incurred in the ordinary course of business and are associated with the assets being transferred.

(l) The aggregate fair market value of the assets Distributing transfers to each Controlled corporation in the Contributions will equal or exceed the aggregate adjusted basis of these assets.

(m) The fair market value of the assets of each Controlled corporation will exceed the amount of its liabilities immediately after the exchange.

(n) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(o) No intercorporate debt will exist between Distributing and either Controlled corporation or between Controlled 1 and Controlled 2 at the time of, or subsequent to, the distribution of the stock of Controlled 1 and Controlled 2.

(p) Payments made in connection with all continuing transactions, if any, between Controlled 1 and Controlled 2, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(q) No parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(r) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50-percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(s) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of either Controlled 1 or Controlled 2 stock entitled to vote, or 50-percent or more of the total value of shares of all classes of either Controlled 1 or Controlled 2 stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(t) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of

§ 355(d)(4)) in Distributing, Controlled 1, or Controlled 2 (including any predecessor or successor of any such corporation).

(u) Immediately after the Distribution, neither Distributing, Controlled 1, nor Controlled 2 will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

### Rulings

Based on the information submitted and the representations provided, we rule as follows with respect to the Proposed Transaction:

(1) Contribution 1 and Contribution 2, together, followed by each respective distribution, will each qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled 1, and Distributing and Controlled 2 will each be "a party to a reorganization" for each respective section 368(a)(1)(D) reorganization within the meaning of § 368(b).

(2) No gain or loss will be recognized by Distributing on the Contributions to Controlled 1 and Controlled 2, respectively, in exchange for stock in Controlled 1 and Controlled 2 (§§ 361(a) and 357(a)).

(3) No gain or loss will be recognized by Controlled 1 or Controlled 2 on the Contributions (§ 1032(a)).

(4) The basis of the assets received by Controlled 1 will be the same as the basis of such assets in the hands of Distributing immediately prior to their transfer to Controlled 1 (§ 362(b)).

(5) The basis of the assets received by Controlled 2 will be the same as the basis of such assets in the hands of Distributing immediately prior to their transfer to Controlled 2 (§ 362(b)).

(6) The holding period of each asset received by Controlled 1 and Controlled 2 in the Contributions will include the period during which Distributing held that asset (§ 1223(2)).

(7) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).

(8) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1 or Shareholder 2 on the Distribution (§ 355(a)(1)).

(9) The aggregate basis of the Controlled 1 stock in the hands of Shareholder 1 immediately after the Distribution will equal Shareholder 1's aggregate basis in the Distributing stock surrendered in the Distribution (§ 358(a)(1)).

(10) The aggregate basis of the Controlled 2 stock in the hands of Shareholder 2 immediately after the Distribution will equal Shareholder 2's aggregate basis in the Distributing stock surrendered in the Distribution (§ 358(a)(1)).

(11) The holding period of the Controlled 1 stock received by Shareholder 1 will include the holding period of the Distributing stock surrendered by that shareholder in exchange therefore, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(12) The holding period of the Controlled 2 stock received by Shareholder 2 will include the holding period of the Distributing stock surrendered by that shareholder in exchange therefore, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).

(13) Any earnings and profits of Distributing will be allocated between Controlled 1 and Controlled 2 in accordance with § 312(h) and § 1.312-10(a).

(14) Any accumulated adjustments account of Distributing will be allocated between Controlled 1 and Controlled 2 in a manner similar to the manner in which any earnings and profits of Distributing will be allocated under section 312(h) between Controlled 1 and Controlled 2 (see Treas. Reg. §§ 1.312-10(a) and 1.1368-2(d)(3)).

(15) Distributing's momentary ownership of the stock of Controlled 1 and Controlled 2, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled 1 or Controlled 2 to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(2)(B) (Rev. Rul. 72-320, 1972-1 C.B. 270).

### Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the Proposed Transaction that is not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

(i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b), (ii) whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or the Controlled corporations or both (see § 355(a)(1)(B) and § 1.355-2(d)), or (iii) whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or either of the Controlled corporations (see § 355(e) and § 1.355-7).

Additionally, no opinion is expressed regarding issues relating to Distributing's, Controlled 1's or Controlled 2's respective subchapter S election.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

*Richard M. Heinecke*

Richard M. Heinecke  
Assistant to the Branch Chief, Branch 6  
Associate Chief Counsel (Corporate)

cc: